

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
August 16, 2002
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85012. Mr. Alan Maguire, Chairman, Arizona State Retirement System Board called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the ASRS office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

1. Call to Order; Roll Call

Present: Mr. Alan Maguire, Chairman
Mr. Bonnie Gonzalez, Vice Chairman
Ms. Charlotte Borchert
Mr. Jim Bruner
Dr. Chuck Essigs
Mr. Norman Miller (Via teleconference)
Mr. Karl Polen
Mr. Ray Rottas

Excused: Mr. N. Carl Tenney

A quorum was present for the purpose of conducting business.

2. Approval of Minutes of the June 20, 2002, Regular Meeting of the ASRS Board

Motion: Ms. Bonnie Gonzalez moved to approve the minutes of the June 20, 2002, regular meeting of the ASRS Board.

Mr. Ray Rottas seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

3. Board Approval of Consent Schedule

Motion: Ms. Bonnie Gonzalez moved to approve the consent agenda:

- A. Retirements, Refunds and Death Benefits
- B. System Transfers

C. Application and Agreements with the Following Employers:

- Juniper Tree Academy
- Sun Lakes Fire District
- Paragon Management Inc., dba Paradise Education Center
- Khalsa Family Services dba Khalsa School

Mr. Jim Bruner seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

4. Director's Report

There were no comments regarding the Director's Report.

5. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance for the Period Ending June 30, 2002

Mr. Terry Dennison, Principal, Mercer Investment Consulting gave an economic overview and presented the ASRS Total Fund Performance for the period ending June 30, 2002.

Total Fund Performance for Periods Ending June 30, 2002

	Qtr	1 Year	3 Years	5 Years	10 Years
Total ASRS Fund	-6.5%	-8.2%	-2.0%	5.9%	10.2%
Benchmark*	-6.3	-8.4	-3.5	4.2	8.7
TUCS Public Fund Median	-5.0	-5.8	-0.3	5.2	9.4

*1/1/89-12/31/91 is 60% S&P 500/40% LB Aggregate,
1/1/92-12/31/94 is 50% S&P 500/40% LB Aggregate/10% EAFE
1/1/95-6/30/97 is 45% S&P 500/40% LB Aggregate/15% EAFE,
7/1/97-12/31/99 is 50% S&P 500/35% LB Aggregate/15% EAFE, and
1/1/00-Present is 53% S&P 500/30% LB Aggregate/17% EAFE.

Performance vs. Benchmarks for the 3 Years Ending June 30, 2002

	Return	Assumed ROR	Std.Dev.	Assumed Std. Dev.
Total ASRS Fund	-2.0%	8.4%	12.5%	11.8%
Benchmark	-3.5		11.2	
Domestic Fixed LB Aggregate	8.0 8.1	5.6	3.6 3.4	5.3
Domestic Equity S&P 500	-7.2 -9.2	9.4	19.2 18.8	16.3
Intl Equity EAFE	-1.9 -6.5	10.0	19.9 17.2	21.5

Performance vs. Benchmarks for the 5 Years Ending June 30, 2002

	Return	Assumed ROR	Std.Dev.	Assumed Std. Dev.
Total ASRS Fund Benchmark	5.9% 4.2	8.4%	13.3 12.1	11.8%
Domestic Fixed LB Aggregate	7.6 7.6	5.6	3.7 3.5	5.3
Domestic Equity S&P 500	5.0 3.7	9.4	20.4 19.9	16.3
Intl Equity EAFE	2.8 -1.3	10.0	20.6 19.2	21.5

Mr. Paul Matson, Chief Investment Officer, explained the contents of two tables included in the Board packet entitled, "Investment Manager Returns vs. Respective Benchmark Returns" and "Combined Asset Class Returns vs. Actuarial Assumption Rate." Mr. Matson pointed out that in the Large Cap manager section of Table 1, there are Large Cap managers that are consistently under-performing and because of this, the Investment Review Committee has directed the ASRS staff to conduct a Large Cap manager search. A short list interview process of these investment managers will begin as soon as early September 2002. He further pointed out that in the U.S. Fixed Income manager section there are two internal portfolios, F1 and F2. These two portfolios are highlighted in red which indicates that the portfolios are under-performing.

Mr. Matson explained that the term alpha is interpreted as the expected out-performance of the investment manager. For example if a manager is expected to out-perform the benchmark by 1%, then it is referred to as the alpha of 1%.

The information provided reflects that all fixed income managers have under-performed during the last quarter. He added that these managers are "top of the line" managers. Some of these managers have positive performance if you look back to their inception date.

Mr. Jim Bruner asked Mr. Matson to explain contracted out-performance. Mr. Matson explained that during the interview phase of a particular manager they are asked to provide an expected out-performance. This figure is determined by looking at the manager's history, then at future expectations. This figure is then noted as an expectation and it is pro-rated per month.

Mr. Matson further explained that the Equity managers are listed in this chart. He pointed out that performance is not consistent among these managers. There are some managers that are out-performing the benchmark and others that are underperforming.

The third category on this chart refers to International managers. These managers have all performed well since inception. In summary, this chart will reflect how each manager is performing during the calendar year.

The final two numbers on the chart indicate the preliminary fund return for the ASRS on a calendar-year basis and a fiscal-year basis.

Mr. Matson added that this report contains information to ensure that the ASRS stays within Board policy on asset allocation and the active/passive allocation of assets. Also, the Board's targeted asset allocation, ASRS' current asset allocation, and the total portfolio assumed mix with tactical asset allocation.

Other important information contained in this report reflects that cash coming in to pay benefits is much less than the cash paid out for benefits. The reason for this is that the contribution rate is much lower than the cost for the benefits. The amount for this on an annual basis is approximately \$700 million a year.

6. Presentation, Discussion and Appropriate Action Regarding the Performance of Fixed Income Managers for the Period Ending June 30, 2002

Mr. Terry Dennison, Principal, Mercer Investment Consulting, Inc., reported on the investment manager's performance for the Arizona State Retirement System (ASRS) (F1), ASRS (F2), Barclays Global Investors (BGI), BlackRock Financial Management, JP Morgan Fleming Investment Management, Inc., and Western Asset Management Company (WAMCO) for the period ending June 30, 2002.

Mr. Gary Dokes, Portfolio Manager/Assistant Chief Investment Officer, and Ms. Lupita Breland, Assistant Portfolio Manager reported on the ASRS' (F1) performance for the period ending June 30, 2002.

	Qtr Ending 6/30/02	YTD02r	Inception*
F1	3.32%	3.26%	6.81%
LB Agg Index	3.69%	3.79%	7.01%
+/- to Index	-0.38%	-0.53%	-0.20%

*From 4/1/98 (Annualized)

Mr. Dokes and Ms. Breland also reported on the ASRS' (F2) performance for the period ending June 30, 2002.

	Qtr Ending 6/30/02	YTD02r	Inception*
F2	3.69%	3.64%	9.43%
LB Agg Index	3.69%	3.79%	9.54%
+/- to Index	0.00%	-0.15%	-0.11%

*From 10/1/00 (Annualized)

Mr. David Lissek, Principal, reported on BGI's performance for the period ending June 30, 2002.

	Quarter	1 Year**	3 Years**	5 Years**	Inception*
ASRS Net Return	3.80%	8.87%	8.26%	7.68%	8.05%
Benchmark Return (Lehman Aggregate)	3.69%	8.63%	8.11%	7.57%	8.01%
Total Value Added Relative to Benchmark	0.11%	0.24%	0.15%	0.11%	0.04%

* ASRS' Inception: 8/31/01

** BGI Fund Performance (inception: 7/31/89)

Ms. Sandra Familet, Director, Account Management, and Mr. Andrew Yorks, Vice President, Portfolio Management, reported on BlackRock's performance for the period ending June 30, 2002.

	Quarter	Rolling 1 Year	Inception*
ASRS Net Return	3.40%	8.43%	6.53%
Benchmark Return (Lehman Aggregate)	3.70%	8.63%	6.42%
Total Value Added Relative to Benchmark	-0.30%	-0.20%	0.11%

* Inception: 11/30/98

Mr. Luke Farrell, Client Portfolio Manager, reported JP Morgan Fleming's performance for the period ending June 30, 2002.

	Quarter	1 Year	3 Years	5 Years	Inception
ASRS Net Return	3.24%	8.47%	8.42%	7.69%	8.50%
Benchmark Return (Lehman Aggregate)	3.70%	8.63%	8.11%	7.57%	8.40%
Total Value Added Relative to Benchmark	-0.46%	-0.16%	0.31%	0.12%	0.10%

Mr. Thomas McMahon, Product Specialist, reported WAMCO's performance for the period ending June 30, 2002.

	Quarter	1 Year	3 Years	Inception*
ASRS Net Return	3.50%	8.47%	8.46%	6.42%
Benchmark Return (Lehman Aggregate)	3.69%	8.63%	8.11%	6.29%

Total Value Added Relative to Benchmark	-0.19%	-0.16%	0.35%	0.13%
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Inception: 12/3/98

7. Presentation, Discussion and Appropriate Action Regarding the Tentative Schedule, Plan of Action, and Request for Proposal for an Executive Search Firm in Connection with the Selection of a New Director

Mr. Alan Maguire, Chairman, began the discussion by referring to documents included in the Board packet. Included in this packet was a proposed advertisement for recruitment, a tentative schedule for recruitment, and a Scope of Work for a request for proposal (RFP) for a search firm for the recruitment of a new Director. Mr. Maguire stated that since the last Board meeting he has been working with members of the ASRS staff and the Department of Administration (DOA), Human Resources Division, to begin to outline a process for the recruitment of the new Director over the next few months.

Mr. Maguire added that the ASRS has already received, with the assistance of Terry Dennison, Mercer Investment Consulting, information on three search firms that have specific expertise in recruitment of retirement personnel. Additionally, five large comparable retirement systems have been identified as agencies that have recently gone through this process. These agencies have been contacted to obtain information about the process, job descriptions, and firms utilized.

Mr. Maguire referred to the tentative schedule and asked the members of the Board to notice that as of August 16, 2002, the Board will review the plan and subject to approval of the Board, the RFP for the search firm will be issued this afternoon. The next steps would include drafting a job description and submitting this draft to the Board for comments, and scheduling a special Board meeting on either September 5 or 9 for the purpose of approving the search firm. Mr. Maguire asked for any comments the Board had in regards to the Scope of Work.

Mr. Jim Bruner asked if there is mention that the contractor will be proactive by actively recruiting individuals that are known for their experience in the area for which the ASRS is recruiting. Additionally, Mr. Bruner referred to Section 2.1(H) with respect to reference checks. He asked if the selected search firm would be required to contract an outside firm that specializes in the area of reference checks. He also asked if the Scope of Work would indicate whether the ASRS will be entitled to another recruitment should the selected individual leave the position within a certain amount of time. Lastly, he asked about specific policy regarding no future recruitment of the ASRS' selected candidate.

Mr. Bob Wittsell, Procurement Manager, responded to Mr. Bruner's questions. Mr. Wittsell stated that a "guarantee" is included in the scope. He added that if the encumbant does not work out for the agency within six months (the industry standard), then the ASRS will receive a refund. This requirement is negotiated as part of the fee schedule. Additionally, Mr. Wittsell stated a clause will be included in the RFP which states, in part, the selected firm will refrain

from recruitment of the individual selected by the ASRS. Lastly, Mr. Wittsell referred to the Scope of Work, which addresses the area of reference checks. It indicates that the reference checks will include personal history and criminal background checks. Mr. Maguire suggested that it include a clarifier stating that these checks can also be completed by the contractor or sub-contractor.

Additionally, Mr. Maguire added that this schedule would allow for the new Director to come on board prior to Mr. LeRoy Gilbertson's scheduled retirement.

Dr. Chuck Essigs stated that the RFP indicates that the selected search firm will gather all resumes and identify the top candidates. The tentative schedule indicates that DOA will handle this process. Mr. Essigs stated that he believes the search firm should handle this process.

Mr. Karl Polen suggested the potential selection firm should be interviewed by a Board committee. Mr. Maguire concurred with Mr. Polen's recommendation.

Mr. Norman Miller stated that a requirement needed to be included in the Scope of Work stating that, "The contractor shall report to legal counsel of the Board any action by any person whatsoever, including any Board member, which the contractor believes in the contractor's professional judgment to be improper or inappropriate interference with the contractor's impartial role."

Motion: Mr. Jim Bruner moved to approve the tentative schedule and plan of action, and Request for Proposal for an Executive Search Firm in connection with selection of a new director, with all changes incorporated as discussed during this meeting.

Dr. Essigs seconded the motion.

Mr. Norman Miller stated that he was uncomfortable with approving the motion until all changes have been incorporated by ASRS staff and a final draft has been disseminated to the Board. Mr. Wittsell stated that this will not be an issue as an RFP can be amended at anytime to reflect any changes.

By a vote of 7 in favor, 1 opposed, 0 abstentions, 1 excused, the motion was approved.

8. Presentation, Discussion and Appropriate Action Regarding the Property Manager of 3300 Tower and Broadway Proper Report

Ms. Jane Simpson, Senior Real Estate Manager, and Mr. Jerry Roberts, Leasing Agent and Senior Vice President, CB Richard Ellis, presented on this topic. Ms. Simpson explained that they are responsible for providing property management, leasing, and construction management services for 3300 Tower and Broadway Proper.

Real Estate Owned

	Qtr	1 Year	3 Years	5 Years	Inception
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3300 Tower	-6.77%	-23.08%	-7.47%	1.44%	8.55%*
Broadway Proper	0.27%	3.72%	14.88%	15.84%	7.45%**

* 8/23/92

** 1/1/96

The overall market conditions for the last 12 months are as follows:

	Vacancy % June 2001	Vacancy % Dec 2001	Vacancy% June 2002	Effective Lease Rates June 2001	Effective Lease Rates Dec 2001	Effective Lease Rates June 2002
Phoenix	12.8%	16.0%	17.4%	\$23.00	\$22.50	\$21.50
Central Corridor	13.0%	16.0%	17.8%	\$20.00	\$18.50	\$17.00
3300 Tower	19.7%	14.7%	19.0%	\$20.00	\$18.50	\$17.00
Tucson	8.8%	9.95%	11.25%	\$17.00	\$17.00	\$17.00
Submarket	8.0%	7.9%	10.25%	\$17.00	\$17.00	\$17.00
Broadway Proper	19.85%	21.90%	22.0%	\$17.00	\$17.00	\$17.00

With the slowing economy, user activity has decreased marketwide while vacancies and concessions have increased. Effective rates have dropped dramatically in Phoenix. Lease rates have remained constant for the past three to four years. In today's market, landlords may be willing to deduct \$1.00-\$1.50 off the rate to secure a high quality tenant.

9. Presentation, Discussion and Appropriate Action Regarding PacifiCare's Medical and Fortis Benefits' Dental 2003 Renewals

On August 5, 2002, the HI/LTD Board Committee met to discuss the contract renewal for the PacifiCare medical and Fortis Benefits dental plans for the year 2003. The committee voted unanimously to recommend to the full Board renewal of the contract according to the negotiations outlined below.

PacifiCare of Arizona, through negotiations with the ASRS staff, has proposed to keep premiums for 2003 identical to those for 2002 except for the non-Medicare HMO plan, which will experience a 3% increase. In order to keep premiums constant, certain benefit levels were adjusted. Attached is an outline of current benefit levels, proposed benefit levels, and the 2003 premium required to maintain the 2002 benefit levels for each medical plan.

Fortis Benefits Insurance Company, through negotiations with the ASRS staff, has proposed to

keep premiums for 2003 identical to those for 2002 with respect to the two “pre-paid” dental plans, and to increase premiums by 12% (a minimum increase of \$1.84 to a maximum increase of \$10.96) for the two indemnity dental plans

The ASRS staff is also recommending that PacifiCare’s two Medicare-eligible plans, the Medicare+Choice HMO and Senior Supplement plans eliminate the vision and hearing benefits and replace them with the Silver Sneakers Fitness Program. Utilization in both medical plans for these particular vision and hearing benefits has been extremely low for the past two years, and there are vision benefits offered by both Fortis Benefits, the current ASRS dental plan carrier, and ScriptSave, the current ASRS prescription drug discount card provider. In addition, members enrolled in both medical plans still will have vision and hearing benefits required because of medical necessity.

The Silver Sneakers Fitness Program was available to ASRS Medicare-eligible retirees until two years ago when the consolidation in carriers (from five to one) occurred. The ASRS received many disappointed calls from members regarding its discontinuance. Its reintroduction should be well received by the retired members of the ASRS.

Motion: Dr. Essigs moved that the Board renew the contract for medical plans to PacifiCare and dental care to Fortis Benefits for the 2003 calendar year.

Ms. Bonnie Gonzalez seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

10. Presentation, Discussion and Appropriate Action Regarding the ASRS Budget Request for Fiscal years 2003-2005

Ms. Bonnie Gonzalez presented the IT Plan and ASRS Budget for fiscal years 2003-2005. Included in the materials provided to the Board are the actual expenditures, the planned expenditures for fiscal year 2003, and the planned expenditures for 2004 and 2005.

Ms. Gonzalez moved to approve the ASRS Budget Request for Fiscal years 2003-2005.

Ms. Charlotte Borchert seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

11. Presentation, Discussion and Appropriate Action Regarding Securities Lending

Mr. Maguire requested that this presentation be postponed until the next Board meeting due to time constraints.

12. Presentation, Discussion and Appropriate Action Regarding the Contract Award for Custody Bank and Other Services

Ms. Bonnie Gonzalez explained that an RFP was issued and the Scope of Work was modified. A total of 18 proposals were received.

Mr. Norman Miller asked why the committee concluded that the services for this contract should consist of bundled services. Mr. Matson explained that the RFP was initially issued with three components to maximize the responses, this also enabled the Evaluation Committee to compare individual respondents in addition to aggregate responses. After much review, it was determined by the committee that it was most cost effective to bundle the benefit services with the other two services.

Mr. Matson further explained there is some efficiency with bundling securities lending services with custody bank services. When these two services are bundled together, you minimize the call back problem on securities on loan, along with various bookkeeping and accounting errors. When securities lending and custody bank services are segregated, another complicating factor is added. This means there is a higher probability of security settlement issues. Mr. Matson stated it was therefore deemed appropriate to bundle these services.

Motion: Ms. Gonzalez moved that contract be awarded to Mellon Bank for custody services.

Ms. Charlotte Borchert seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

13. Presentation, Discussion and Appropriate Action Regarding a Request for proposal for a Retirement System Governance Study

Mr. Maguire stated that the scope of work has been drafted and must be approved so that it can be submitted to the State Procurement Office for issuance of a request for proposal.

Ms. Charlotte Borchert pointed out that the Board was not aware of Mr. LeRoy Gilbertson's retirement at the time the ASRS Governance study process was started. She asked if the new Director would be included in this process. Mr. Bruner answered that this was going to be a long process. The new director should be informed that this is a long-term project.

Mr. Norman Miller stated that an analysis of the Board's fiduciary duties should be included in the scope of work. This analysis would include the Board's strategic and critical role, along with proxy voting issues.

Motion: Mr. Jim Bruner moved that the Board approve the Scope of Work for the ASRS Governance be submitted to the State Procurement Office for issuance of a request for proposal.

Ms. Bonnie Gonzalez seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

14. Board Requests for Additional Items

None.

15. Call to the Public

Ms. Pat Evans, ASRS Member, addressed the Board and stated that she has experienced great difficulty in receiving a correctly calculated amount on her retirement check. Ms. Evans does not understand why it is taking as long as five months for her benefit to be correctly calculated.

16. Adjournment of the ASRS Board

Mr. Alan Maguire, Chairman, adjourned the August 16, 2002, meeting of the ASRS Board at 12:19 p.m.

Respectfully submitted,

Marina Chaves, Secretary

Date

LeRoy Gilbertson, Director

Date